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IN THE

Supreme Court of the United States

October Term, 1957

No. 856

EDWARD POOL and LOTTIE POOL, EDWARD POOL, LOTTIE POOL, WILLIAM K. MURPHY, EDNA MURPHY, WILLIAM K. MURPHY and EDNA MURPHY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

REPLY BRIEF FOR THE PETITIONERS.

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1. If the Tax Court's decision in this case had been reviewed by the Courts of Appeals for the Third, Seventh or Eighth Circuits, there would have been a reversal pursuant to the precedents established in those Circuits, and the taxpayers would have been held to have realized capital gain on the sale of property originally acquired for investment. The taxpayers have, however, been taxed in a different manner simply because their returns were filed in a geographic area within the jurisdiction of the Ninth Circuit and because that Court does not apply the same principles in cases of this kind.

The Commissioner, however, refuses to acknowledge the existence of a conflict, contending that nothing more

is involved than a factual question, that each case turns on its own record, and that, since no two cases are alike, differences in result at the appellate level "are not only inevitable but also appropriate." (Resp. Br. 16.)

But the hard fact is that the Circuits are applying diametrically opposed concepts to one of the most important and frequently litigated provisions of the Internal Revenue Code. And this would not be the first time that an important, frequently litigated issue was permitted to remain in a chaotic state for some time because the Government was, at first, so confused as to what are the factual elements of a case as to be unable to discern that decisional differences existed.[1] There are important differences here

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[1]A recent example will be found by comparing the Government's brief in opposition in *Stuyvesant Town Corp. v. United States*, 111 Fed. Supp. 243 (Ct. Cl.) certiorari denied, 346 U. S. 864 (No. 167, October Term, 1953) with its petition for a writ of certiorari in *United States v. Leslie Salt Co.*, 350 U. S. 383 (No. 793, October Term 1954).

In the former, the Government's brief in opposition was framed along the same lines as the one filed in this case, namely, that only a factual issue was involved, that the applicability of the statute depended on all the facts and circumstances, that neither the presence nor absence of any particular fact was controlling, and that each case turned on its own circumstances. The Government also, as it does here, pointed to the fact that it had refrained from applying for certiorari from earlier decisions adverse to it.

In the *Leslie Salt* petition (pp. 14-15), filed only one term later, and involving the identical issue, the Government contended that the differences between the Circuits "are differences as to the legal definition of 'debentures' and 'certificates of indebtedness' as those terms are used in the stamp tax statute", and admitted that it had been wrong in its earlier supposition that the varying decisions could "somehow be reconciled in terms of variations in the factual composites they represent."

We need scarcely add that this Court's decision in *Leslie Salt*, while adverse to the Government, did succeed in settling the basic principles involved and did result in the elimination of litigation in an area which had previously been the source of considerable controversy.

and they can and should be resolved by this Court to the end that future litigation will be minimized and that uniform results can be achieved by the lower courts.

The Commissioner's "why bother?" approach possesses a beguiling, initial simplicity. It would, indeed, be inappropriate for this Court to review an isolated fact question if the Courts of Appeals were applying similar standards and if differences in their decisions reflected nothing more than factual variations in the cases. But, the surface plausibility of this position is dispelled by even a cursory examination of what is involved, and a studied evaluation confirms that hard and fast differences exist between the Courts of Appeals.

The Solicitor General fails in his responsibility of assisting this Court in the selective process of certiorari when he substitutes pat phrases for the more painful process of reasoning and stamps "factual question" on a case where the contents will be found not to have been honestly labeled. And, surely avoidance of review by this Court and the possibility of a decision adverse to the Government should not be so important to warrant the gamble that a hasty reading of the Government's brief in opposition will not lay bare the coloring and occasional misstatement of facts, the use of misleading quotations from decisions, and its attempt to gloss over the conflict that does exist.

We cannot, we regret, be as terse as the Government's brief in opposition; but analysis and accuracy, while a lengthier process than misleading generalization, may eventually prove more helpful to an orderly, uniform development of the tax law.

2. We will avoid that "delusive simplicity" of attempting to draw unyielding lines between questions of law and

questions of fact, a goal which others have also found to be a "will-of-the wisp."[2]

Since a statute is involved, we submit that some generalizing principles have been established as the legislative standard, and that Congress did not intend that the lower Courts should have full freedom to arrive at willy-nilly results from case to case as though there were no ultimate guidelines and as though the decisional process involved nothing more than a throw of dice. We also submit that where the Courts of Appeals, while accepting the fact finder's version of the underlying facts, nevertheless reverse a lower court, they do so by the application of some standards derived from the statute and because of a conviction that the factual elements, as determined below, when fitted against the statutory standard, do not justify the ultimate conclusion reached.

Where some Courts of Appeals display a consistent pattern in the approach which they take under a particular section of the revenue law and that pattern is discernibly different from that followed by other Courts of Appeals, the net effect is one of a fundamental conflict of principle where litigants are taxed differently on transactions which are fundamentally the same. And, where the Courts of Appeals, in following such a pattern, consistently reverse the lower courts, the conflict is no less clear regardless of whether, in reversing, they frame their decisions

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[2]Isaacs, *The Law and the Facts*, 22 Col. L. Rev. 1. See also Paul, *Dobson v. Commissioner: The Strange Ways of Law and Fact*, 57 H. L. Rev. 753.

in terms of a clear mistake of law on the part of the lower court, or describe its conclusion as "clearly erroneous", or disagree with the criteria employed.

3. We turn, then, to examine the precise issue here to determine whether, as we maintain, there is a fundamental conflict between the Circuits or whether, as the Commissioner claims (Br. 16) these differences "are not only inevitable but also appropriate".

Specifically, the Tax Court has consistently taken the position that the purpose for which property is originally acquired is not of critical significance in determining whether subsequent sales are in the ordinary course of a trade or business so that, even if property was not originally acquired for resale in a business, later sales (if not made to a single purchaser) can constitute a trade or business, depending on the total factual complex, and that various criteria are to be employed in making that determination, including the frequency of the sales, how actively the sales were promoted, how actively the taxpayers were engaged in making the sales, what other business activities the taxpayers were generally engaged in, before, during, and afterwards, and what other business entities the taxpayers are interested in. The Tax Court's view of the statute is shared by the Court below, by other Courts of Appeals, and it also reflects the Commissioner's position.

If the Tax Court and these Courts of Appeals were correct in this premise, *i.e.*, that one can become engaged in a business when liquidating investment property by

piecemeal sales, and if all the Courts of Appeals were agreed on this principle, certiorari would not be appropriate.

But the fact is that the Third, Seventh and Eighth Circuits have rejected this basic premise. Those Courts demonstrably apply the principle that where property is originally acquired as an investment, the subsequent liquidation of the investment does not amount to the conduct of a business *regardless* of the frequency of the sales, the activity of the taxpayers in conducting the sales, their other business activity, etc., so that the criteria listed above are not, in the view of these Courts, relevant in these particular circumstances. If we are correct in this, the differences between the Courts of Appeals is not one which can be casually tossed aside as reflecting differences in judgment on factual variations.

It may be helpful, in demonstrating this, to compare the facts of this case with *Curtis Co. v. Commissioner*, 232 F. 2d 167 (C. A. 3rd) in accordance with the criteria which the Commissioner and the courts below deem significant.

	Curtis Co.	Pool-Murphy
Nature of property	Houses	Houses
Purpose of original acquisition	Rental-investment; and not for sale to customers in ordinary course of business. Tax Court considered this not decisive.	Rental-investment; and not for sale to customers in ordinary course of business.[3] Tax Court considered this not decisive.
Purpose of liquidation	Market value had increased so that it was more profitable to sell than to continue to rent.	Market value had increased so that it was more profitable to sell than to continue to rent.
Frequency and continuity of sales	1,386 houses sold to individual purchasers over a 4-year period. Tax Court found the sales were frequent and continuous.	70 duplexes sold within 10-week period; 100 duplexes sold within 12-month period.
Activity of Taxpayer	Taxpayer a corporation. Sales made by ~~its own~~ employees who engaged in "aggressive sales effort."	Individual taxpayers. Sales made by broker. Taxpayers signed deeds and escrow instructions prepared by broker and helped obtain source of financing for some units.
Advertisements	Advertised by the taxpayer.	Advertisements composed, placed and paid for by broker.

[3]See Petition, fn. 4, p. 11 and *infra*, p. 14.

	CURTIS CO.	POOL-MURPHY
Other business activities	The corporate taxpayer, prior to, simultaneously with and immediately after the sales was engaged in an extensive business of building and selling other houses to customers.	Mr. Pool, fifteen years previously, had built houses for resale. Otherwise the taxpayers had not, individually nor as a partnership, bought and sold improved or unimproved real estate. Previously, all the taxpayers held the stock of a corporation, which had built and sold houses, and two of the taxpayers performed services for it. Four years after the sales, two of the taxpayers, together with a third person, owned the stock in and were employed by two corporations engaged in the business of building and selling houses.
Use of liquidation proceeds.	Apparently invested in the taxpayer's real estate business.	Invested in securities and in a rental building.

The Commissioner asserts (Br. 17) that our assumed facts are not the record facts and that our reliance on *Curtis* "to show a conflict is thus misplaced". How do the facts which we state differ from those found by the Tax Court? The Commissioner chooses to be mute. And how do the facts of the present case differ from *Curtis?* The Commissioner does not say. If the differences are that: Curtis was simultaneously engaged in the business of building and selling houses for resale, while taxpayers were interested as officers and stockholders (in earlier and later years) in corporations so engaged and Pool had earlier been so engaged as an individual; that Curtis advertised and made the sales through its own employees, while the taxpayers here used a broker, signed the necessary papers and arranged some financing; that Curtis made a greater number of sales over a longer period of time (having more houses to sell), while the taxpayers sold less houses over a shorter period of time; that Curtis reinvested the proceeds in its real estate business, while the taxpayers invested in securities and in rental properties, we agree that there are differences. But they sharpen rather than dispel the existence of the conflict for they demonstrate that the Third Circuit would even more readily have reversed the Tax Court's decision in this case.

It would unduly extend our reply to make a similar, extended comparison with the facts of the other conflicting decisions of the Seventh and Eighth Circuits. We confidently state, however, that the Commissioner's criteria, whether considered singly or in totality, will not show any relevant distinctions between the cases. If the liquidation of an investment can be transformed into a business because the sales are frequent and extensive, are actively

promoted, because the taxpayers play some part in making the sales, and because the taxpayers have some contact, directly or indirectly, with some other recognized business of selling to customers, we submit that each of the other cases presented a stronger factual picture from the Government's point of view for the denial of capital gains.

The Commissioner does not quarrel with the correctness of these other decisions. And yet, surprisingly enough, he does not, because he obviously can not, point to one single factual element which would permit a rational distinction to be drawn or which would demonstrate why, if the Tax Court's decision here was properly affirmed, there was warrant for the reversals in these other cases.

The conclusion is inevitable that no valid distinguishing facts exist, and that the decisional results cannot be harmonized by some vague notion that a "fact" question is resolved.

4. The Courts of Appeals for the Third, Seventh and Eighth Circuit, contrary to the Commissioner, do recognize that a generalizing principle is involved, that their judgments have some more rational basis than is involved in a throw of dice, and that their views are in conflict with other Circuits.

For example, the Commissioner (Br. 18, fn. 13) says that in *Greenspon v. Commissioner*, 229 F. 2d 947, 952, the Eighth Circuit reached the conclusion "that the apparent conflicts are to be resolved by a 'more thorough and complete survey of the entire factual situation' ". What the Court actually said (p. 952) was that "perhaps *in some instances*" the apparent conflict can "be explained on the basis of factual differences" and it quickly added *"There*

also appear to be differences in the law applied. It would be impossible to reconcile all the conflicting decisions . . ." (Italics added). Significantly, it also observed that the cases denying capital gain treatment appear to do so by finding "a few similarities" with the way a business is ordinarily conducted and that "On the other hand, it would seem that in general the cases permitting capital gains treatment reached that result after *a more thorough and complete survey of the entire factual situation*". It was from this sentence that the Commissioner lifted the italicized language and transposed it to an opposite context.[4]

The Seventh Circuit, too, is of the view that it is applying a general principle in cases of this kind. Thus, in *Three States Lumber Co. v. Commissioner*, 158 F. 2d 61, 63, it said: "The conclusion of the Tax Court raises a clear-cut question of law . . ." And in *Chandler v. Commissioner*, 226 F. 2d 403, it held that it was reversible error for the lower court to conclude that very extensive, long-continued, piecemeal sales of tremendous acreage could be a business or taxed differently than if all the property had been sold at one time.

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[4]In attempting to establish that the Eighth Circuit regards the issue as one of pure fact, the Commissioner also makes it appear that the language quoted in his footnote 13, Br. p. 18, was from the Eighth Circuit's opinion in *Dillon v. Commissioner*, 213 F. 2d 218, 220, when it actually is from the Tenth Circuit's opinion in *Home Co. Inc. v. Commissioner*, 212 F. 2d 637, 641, and was set forth in *Dillon* with neither express approval nor disapproval. That in *Dillon*, as in *Greenspon*, the Eighth Circuit recognized that it was applying a general principle under the statute is evident from its rejection of the Tax Court's view that it was not significant that the taxpayer was liquidating an investment and its statement (p. 220) ". . . We think the principle applied is neither legal nor reasonable, but that it is clearly erroneous."

The Third Circuit is fully aware of the difference between a reversal of the Tax Court where the record does not support its view of the primary facts and a reversal based on its having applied the erroneous principle which is in issue here. In *Philber Equipment Corp. v. Commissioner*, 237 F. 2d 129, referring to the Tax Court's conclusion that the property was being held for sale to customers in the ordinary course of its trade or business, the Court of Appeals said (p. 131):

> "With respect to that finding it must be noted that it was in the nature of an ultimate finding of fact and since such finding is *but a legal inference* from other facts it is subject to review free of the restraining impact of the so-called 'clearly erroneous' rule applicable to ordinary findings of fact by the trial court, as we recently held in *Curtis Co. v. Commissioner*, 3 Cir. 1956, 232 F. 2d 167 . . ." (Italics added.)

To the extent that the Tax Court in *Philber* had found what was the original purpose in the acquisition of the property, the Court of Appeals recognized, pages 132-133, that it was reviewing a primary question of fact and overturned that finding because it was not supported by the record. To the extent that the Tax Court made an alternative conclusion, namely, that even if the property was not originally acquired for purposes of resale, the decisive factors were the intention to sell, the manner of sale, etc., the Court of Appeals recognized that an interpretation of the statute was involved and reversed because the Tax Court's reading of the statute was erroneous, saying (p. 133):

> "We cannot subscribe to this 'alternative ground'. To do so would make for judicial nullification of Section 117(j).

> "The essence of the Tax Court's alternative ground is that property changes character merely by the fact of its being exposed for sale. We agree with the taxpayer that such a concept is neither logical nor reasonable."

Curtis Co. v. Commissioner, 232 F. 2d 167, also proves the point. With respect to property (unimproved land) which the Tax Court had found, on conflicting evidence, to have been originally acquired for ultimate resale, the Court of Appeals recognized that the problem was essentially evidentiary and affirmed the holding that the proceeds were taxable as ordinary income, because (p. 171) "We cannot say under these circumstances that the Tax Court was wrong in reaching the conclusion which it did."

But, with respect to the houses which, concedely, were originally acquired for rental purposes, it reversed, even though the "criteria" which the Commissioner would apply were as strong or stronger as to the unimproved land as they were with respect to the houses. Thus, the difference in original purpose of acquisition was the crucial fact on which the appellate court reached different results as to different property in the very same case.

It was, undoubtedly, these considerations that convinced the court below (Pet. App. 4, fn. 6) that *Curtis* embodied a "seemingly contrary conclusion," even though the Commissioner is able to view all the decisions as being harmonious and appropriate in the different results which they embody.

5. We do not know, as we have previously observed, on what basis the Commissioner, in his attempt to negate the existence of a conflict, makes the assertion (Br. 17) that our "assumed facts" are not the record facts here.

We note that the Commissioner makes no attempt to document this false accusation. We also point out that, on the contrary, the Commissioner's summary (Br. 15) of the facts, which he says fully justify the decision below, is misleading and inaccurate. We shall enumerate:

(a) "Taxpayers acquired the property from Artcraft for rental or sale."

As to two of the taxpayers, Edward Pool and Lottie Pool, the express finding of the Tax Court was to the contrary, namely, that their purpose was to acquire and hold the properties for rental purposes. [R. 82-83.] As to William and Edna Murphy, the finding is less clear, but the Tax Court refrained from finding that there was an intent to sell to customers in a business. The Court of Appeals viewed the Tax Court as having found that *all* the taxpayers had (Pet. App. 31) "an original rental object later changed into sale . . ." See also Pet. 11, fn. 4.

Equally important is that the Tax Court did not believe that the original purpose was critical, for it taxed the Pools no differently than the Murphys, and it held here, as it has fairly uniformly, that the original purpose was not significant. This, of course, is the starting point for the division in the Circuits.

(b) "The houses were held only for rental during a period when war-time restrictions made sales less profitable than rentals." (Resp. Br. 15.)

There were no restrictions on the sales of these properties. There were restrictions on the selling price, *i.e.*, the price could not exceed $6,000 per unit, or fair market value, whichever was lower. [R. 39-40.] This restriction was removed by Executive Order on October 15, 1945. [R. 54.] Prior to the removal of this restriction, the fair

market price was *less* than the ceiling price and the same was true for some period thereafter [R. 362]. This is evident from the fact that of the first group of duplexes, sold in 1946, 64 were sold at *less* than ceiling price, at $5,900 per unit or $11,800 per duplex, and only 6 were sold at $6,100 per unit or $12,200 per duplex [R. 64].

It simply is not true, nor did the Tax Court make such a finding, that war-time restrictions made sales less profitable than rentals. It was the later return of servicemen which enhanced the value of real estate in this area and which made liquidation more profitable than a continued investment in rental housing subject to rent control.

(c) "As soon as the restrictions were removed, taxpayers terminated the leases and encouraged vacancies" (Resp. Br. 15).

The taxpayers did not terminate any leases. Sometime after April 10, 1946, the date when the last lease was written, the taxpayers adopted the policy of not renewing any expiring leases [R. 54]. This policy, moreover, was not adopted "as soon" as restrictions were removed on ceiling prices, but six months later. Vacancies were, quite obviously, not encouraged until there had been a decision to dispose of the properties and that was not until sometime in May, 1946, with respect to the 70 duplexes, and not until July or August, 1946, with respect to the 100 duplexes.[5]

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[5]In our petition (p. 20) we recognized that a taxpayer could impart values by personal efforts in improving, for purposes of resale, what was originally investment property and thus change the character of the property so that it would no longer qualify for capital gain. Compare the unreasoned statement by the Government (Resp. Br. 17, fn. 10) that failure to renew leases, permitting vacancies to occur, and selling a few houses to tenants "did change the rental property." And this is the only instance of where the Government offers a concrete argument as to how the factual elements fit the statute!

(d) "While a broker was hired to sell the houses, taxpayers advertised the houses for sale by the builders, and otherwise actively participated in the sales promotion, procuring the financing for many of the houses." (Resp. Br. 15.)

The Tax Court's finding is that the broker, not the taxpayers [R. 60] "wrote the copy for and placed and paid for the adversiting . . ." While some of the advertisements referred to Artcraft as the builder and some stated that the properties were being sold by the builder, the Tax Court did not find that these statements were known to the taxpayers and, indeed, it evidently attached no importance to the circumstance for it did not even mention it in its opinion.

The extent to which the taxpayers "actively participated in the sales promotion" amounted to no more than putting their signatures, sometimes in advance, on escrow instructions and on deeds which were prepared by the broker. Their signatures were, of course, a necessity for the passage of title. Murphy did assist in arranging for the financing of some of the properties.

(e) "After the sales of the housing units, taxpayers resumed the business of building and selling houses." (Resp. Br. 15.)

The Commissioner avoids mentioning that the proceeds of the sale were immediately invested in securities and in a rental building [R. 210-213, 514] and that it was not until 3 and 4 years later that Murphy and Pool, together with a third party, acquired the stock interest in and worked for two corporations engaged in building and selling houses (if that can accurately be described as a resumption of business by these two taxpayers).

The above is an analysis of the Commissioner's misleading summary of the relevant facts which he asserts (Br. 15) "warrants the Tax Court's conclusion". But even if this were an accurate summary, the pertinent question would still remain—how do the facts differ from *Curtis* (or the other cases on which we rely) and on what basis does the Commissioner concede that the Third Circuit's reversal in *Curtis* was correct, while the opposite conclusion is appropriate here?

We contend that no such basis can be found. The only possible conclusion is that, whether on the Commissioner's version of the facts or on the basis of the actual facts found by the Tax Court, the Third Circuit would have reversed the present decision on the authority of its *Curtis* and *Philber* decisions, as would the Seventh or Eighth Circuits, if this case had been reviewed there. There is, quite clearly, a serious conflict which ought to be resolved.

Conclusion.

For the reasons stated in our Petition and amplified here, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted.

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April 21, 1958.